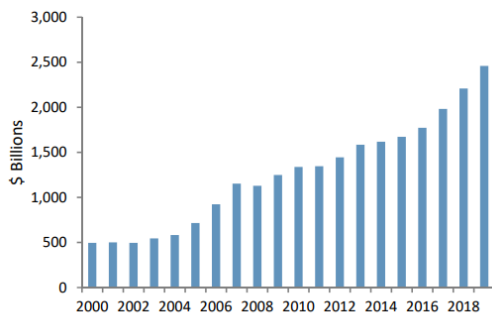


ALEXET CAPITAL ASSOCIATES

Revisiting Article 9 – An Alternative for Middle Market Lenders

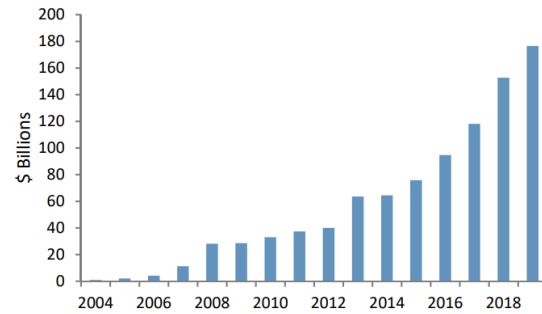
For the last decade, increasing amounts of private equity/direct lending capital have been deployed into middle market companies. Leverage levels nearing 4-5x EBITDA on transaction multiples of ~10x+ have reduced the margin of safety for lenders. In the event of stress from COVID-19 or otherwise, the appetite to fund companies through operating and financial challenges may simply not exist.

U.S. Private Equity Assets Under Management



Source: Preqin, June 2019.

U.S. Direct Lending Assets Under Management



Source: Preqin, June 2019.

For those companies facing capital shortfalls, secured lenders may find themselves evaluating several options to preserve and recover value: (1) Chapter 11 with a potential 363 sale of the business, (2) Assignment for the Benefit of Creditors, and (3) a going concern Article 9 Uniform Commercial Code (UCC) Foreclosure.

Unfortunately, for middle market companies of limited scale, the professional costs of counsel, restructuring advisors, bankers, etc. may prove prohibitive to an effective Chapter 11 / Section 363 Sale. In addition, the timeframe to administer a Chapter 11 process may be elongated given the involvement of multiple parties in interest with standing (e.g., unsecured creditors committee). An Assignment for the Benefit of Creditors (ABC) may present relative cost advantages versus a Chapter 11, but limitations on operating the business via an Assignee poses material challenges to preserving business value, particularly for longer cases.

In contrast to Chapter 11 or an ABC, for many types of companies, a UCC Article 9 Foreclosure presents the opportunity for a secured lender to cost effectively recovery value in an expeditious manner through a sale of company assets as a going concern.

As background, the Uniform Commercial Code (UCC) was developed in the 1950s as a standardized, comprehensive set of laws and regula//tions with the objective of harmonizing all interstate business transactions. The UCC covers areas such as the sale/lease of goods, investment securities, financial transactions, negotiable instruments, and secured transactions. The UCC is not federal law, but rather it has been uniformly adopted in large part by all 50 states, thus providing uniformity of treatment for business transactions. Article 9 of the UCC deals primarily with secured lending transactions.

Article 9 foreclosures are most impactful for secured lenders that hold perfected collateral liens over most, if not all, of a company's tangible and intangible assets.¹ In the event of default, a secured lender may enact a disposition of the business collateral via Article 9 (Section 610) as long as the disposition is commercially reasonable "including the method, manner, time [and] place" (§9-610). The sale need not be approved or confirmed by court action.

One approach to meet the standard set in §9-610 is to enlist an investment banker, or some type of sales agent, to execute a public sale process for the business collateral. For the secured lender who desires to own the assets of the company, a public sale process also allows the lender to credit bid its P&I claim amount (including fees and expenses). The timeline for executing the marketing/sale process can be as short as 60-70 days, thereby minimizing disruption and preserving going concern value for the buyer.

From a cost perspective, the simplicity of an Article 9 foreclosure process becomes abundantly clear when in comparison to the numerous but necessary motions and meetings required under Chapter 11/ABCs. By contrast, the secured lender has a definitive right to the business collateral assuming lien perfection, and the UCC provides a clear path for the lender to selling or owning the business collateral.

Under the right circumstances, a going concern Article 9 provides significant cost and time advantages and should be carefully weighed versus more traditional restructuring alternatives. Please feel free to contact us with any questions you may have about Article 9 dispositions or any other debt restructuring, workout or bankruptcy issues that you may confront.

¹ The UCC Article 9 addresses liens perfected on personal property and excludes certain collateral such as real property, property governed by Federal statutes/regulations or Certificate-of-Title laws, certain insurance policies, and in-the-ground collateral. Practitioners should be mindful of collateral whose treatment lies outside the span of the UCC.